

STATE OF INDIANA

INDIANA UTILITY REGULATORY COMMISSION

SOUTHERN INDIANA GAS AND)	
ELECTRIC COMPANY)	
d/b/a VECTREN ENERGY)	CAUSE NO. 43839
DELIVERY OF INDIANA, INC)	
(VECTREN SOUTH – ELECTRIC))	

DIRECT TESTIMONY

OF

WES R. BLAKLEY - PUBLIC'S EXHIBIT NO. 9

ON BEHALF OF

THE INDIANA OFFICE OF UTILITY CONSUMER COUNSELOR

JUNE 25, 2010

TESTIMONY OF WES R. BLAKLEY
CAUSE NO. 43839
VECTREN SOUTH-ELECTRIC

1 **I. Purpose and Qualifications**

2 **Q: Please state your name and business address.**

3 A: My name is Wes R. Blakley and my business address is 115 W. Washington St.
4 Suite 1500, South, Indianapolis, Indiana 46204.

5 **Q: By whom are you employed and in what capacity?**

6 A: I am a Senior Utility Analyst for the Office of Utility Consumer Counselor
7 (OUCC).

8 **Q: Please summarize your educational background and experience as an**
9 **accountant.**

10 A: I earned a Bachelor of Science Degree in Business with a major in Accounting
11 from Eastern Illinois University in 1987. Upon graduation, I worked as a
12 Revenue Accountant and later as a Billing Supervisor for Illinois Consolidated
13 Telephone Company. My primary duties included supervising the audit of the
14 billing system, analyzing and recording revenues and filing related sales and
15 excise tax returns. I continued in that capacity until April 1991, when I accepted
16 a staff accountant position with the OUCC. I have attended the NARUC annual
17 regulatory studies conference in Lansing, Michigan.

18 **Q: Have you previously testified before the Indiana Utility Regulatory**
19 **Commission (IURC)?**

20 A: Yes. I have testified in water, sewer, electric and gas utility rate case proceedings.

2 A: The purpose of my testimony is to review and make recommendations on Vectren
3 South-Electric's (Vectren South or Petitioner) request for the inclusion of variable
4 production costs (VPC) in its existing Reliability Cost and Revenue Adjustment
5 (RCRA) tracker. I will also comment on and make recommendations regarding
6 Petitioner's requested treatment of its Wholesale Power Margins (WPM) in the
7 RCRA tracker.

9 **Q: Briefly describe how the RCRA was created.**

13	1.	Non-Firm Wholesale (NFW) margins.
14	2.	Municipal Wholesale (MW) margins
15	3.	Purchased Power Non-Fuel costs
16	4.	Environmental Chemical costs
17	5.	Environmental Emission Allowance credits (net of costs)
18	6.	Direct Load (DLC) billing credits
19	7.	Interruptible Sales billing credits

20 That case resulted in a settlement, in which the parties agreed to rename
21 the GCRA the Reliability Cost and Revenue Adjustment (RCRA) tracking

1 mechanism.¹ The Settlement Agreement, approved in the Commission's Order
2 dated August 15, 2007, included the following elements: approval of the RCRA
3 tracking mechanism and tracking of all items listed above within the RCRA
4 *except* for Direct Load Control billing credits, which were approved to be
5 included in Petitioner's Demand Side Management Adjustment (DSMA) tracker;
6 the Petitioner's Environmental Chemical Costs request, in which certain chemical
7 costs were included in rates at a pro forma level; and certain chemical costs which
8 were tracked in Petitioner's active environmental trackers, specifically, its
9 operating expense adjustment tracker (OER).

10 **Q: Does Petitioner request any changes to its RCRA in this filing?**

11 A: Yes. First, Petitioner seeks to track from a test year level of environmental
12 emission allowances of \$515,108 for native retail customers. OUCC Witness
13 Cynthia M. Armstrong provides testimony with respect to the OUCC's position
14 on environmental emission allowances. Second, Petitioner proposes to lower the
15 \$10.5 million wholesale power margins base level that was established in its last
16 rate case, Cause No. 43111, to a new base level of \$5.98 million. Petitioner
17 proposes to continue to equally share any gains above this level, as well as any
18 losses below this level with ratepayers. Finally, Petitioner proposes to track
19 variable production costs in the RCRA.

20
¹ To avoid confusion between Petitioner's original proposal and the settlement, I will refer to it as the Reliability Cost and Revenue Adjustment (RCRA) tracking mechanism in my testimony.

III. Variable Production Costs

Q: Please identify the variable production costs Petitioner proposes to track in the RCRA and the dollars associated with such costs.

A: Petitioner is proposing to include variable production costs, which fall into four expense categories: (1) chemicals associated with the operation of SCRs and scrubbers, which include lime, soda ash, limestone, ammonia and catalyst; (2) coal combustion byproduct disposal, which includes fly ash, bottom ash, and scrubber by-product including gypsum; (3) fuel handling; and (4) boiler water chemicals.

Vectren South is proposing to include a pro forma base level for VPC of \$24,194,522, from which Petitioner would track up or down (gains or losses) in the RCRA.² Vectren South also proposes VPC be allocated to customers based on energy (kWh) sales, adjusted for line losses.³

Q: Did Petitioner request environmental chemical expenses as well as other chemical expenses to be tracked through a tracking mechanism in its last rate case, Cause No. 43111?

A: Yes. In Cause No. 43111, Petitioner requested environmental chemical expenses, as well as other chemical related expenses, to be tracked through the RCRA.

Q: What was the result of Petitioner's request regarding environmental chemical expenses and other chemical expenses in its last rate case, Cause No. 43111?

A: A Settlement was reached in Cause No. 43111 and the provision for tracking the chemical costs was removed.

² See Vectren South Witness Ronald G. Jochum's Testimony, Exhibit RGJ-3.

³ See Vectren South Witness Scott Albertson's Revised Testimony, Page 14, Lines 2-4.

1 **Q: What position did the OUCC take in Petitioner's last rate case, Cause No.**
2 **43111, with regard to tracking environmental chemical expenses and other**
3 **chemical expenses through the RCRA, and what is the OUCC's position**
4 **regarding Petitioner's request to track VPC through the RCRA in this**
5 **proceeding?**

6 A: The OUCC opposed Petitioner's request to track environmental chemical
7 expenses and other chemical expenses through Petitioner's RCRA. The reasons
8 for excluding these individual expenses in Petitioner's last rate case are the same
9 reasons the OUCC opposes inclusion of VPC in the current rate case. Such
10 tracking may disproportionately address costs which trend upward without
11 tracking other costs which trend downward or revenues that increase.

12 **Q: Could Petitioner's request be considered "piecemeal" ratemaking?**

13 A: Yes. The Commission defined piecemeal ratemaking in its Cause No. 40402,
14 Order dated September 19, 1996, stating:

15 Piecemeal ratemaking is when discrete components of a utility's
16 operations are treated singularly, rather than as a part of that
17 utility's larger financial picture. Such treatment is disfavored
18 because, while costs may have increased in one aspect of
19 operations, they may be offset by decreased costs elsewhere, or by
20 increased income.⁴

21 **Q: What does Petitioner identify in testimony as the primary factors supporting**
22 **its proposal to track these operating costs in the RCRA?**

23 A: Vectren South Witness Mr. Ronald G. Jochum provides two primary factors for
24 tracking these operating costs: (1) unit run levels, and (2) natural gas and fuel
25 prices. The former is a result of market conditions. If Petitioner's units are
26 economical they will be dispatched by the Midwest ISO; if they are not

⁴ See Northwest Indiana Water Company, IURC Cause No. 40402, Commission's Approved Order dated September 19, 1996, Paragraph 8(a).

1 economical, they will not be dispatched and will remain idle. If they remain idle,
2 chemical and other variable costs will be reduced, and if they are dispatched,
3 those same costs will rise.

4 **Q: Should a tracking mechanism for variable production costs be established?**

5 A: No. Those same market conditions that affect Petitioner, are also affecting other
6 electric utilities. The market constantly changes and companies manage within
7 these market changes. There are no guarantees that Locational Marginal Price
8 (LMP) will remain low or high. As for the price of natural gas and fuel oil, they
9 too fluctuate like many other costs a utility manages. Petitioner describes VPC to
10 be significantly volatile costs with the potential for annual changes in VPC in the
11 order of magnitude of plus or minus \$8 - \$10 million with historical VPC ranging
12 between \$18.23 – \$25.28 million (approximately \$7.05 million in fluctuations)
13 during the period 2006 through 2008.⁵ Petitioner's test year cost of VPC is \$22.9
14 million and its adjusted pro forma amount in this Cause is \$24.19 million.⁶ This
15 does not indicate a great fluctuation or volatility from the historical range
16 (previous years) for VPC. Therefore, the OUCC recommends that the chemical
17 and other operating costs, as adjusted pro forma included in Petitioner's VPC
18 tracker request, be recovered through base rates and not recovered through the
19 RCRA tracking mechanism.

⁵ See Vectren South Witness Ronald G. Jochum's Testimony, page 19, lines 24-26; and page 11, lines 5-6.

⁶ See Vectren South Witness Ronald G. Jochum's Testimony, page 10, lines 29-30.

1 **IV. Wholesale Power Margins**

2 **Q: How does Petitioner propose to treat its Wholesale Power Margins in this**
3 **proceeding?**

4 A: As indicated previously in my testimony, Petitioner proposes to lower the current
5 \$10.5 million wholesale power margins base level that was established in Vectren
6 South's last base rate case, Cause No. 43111, to a new base level of \$5.98 million,
7 in which Petitioner proposes to continue to share 50/50 of gains above this level,
8 and 50/50 of losses below this level.

9 **Q: Is Petitioner's requested treatment of WPM different from how WPM is**
10 **currently treated?**

11 A: Yes. With respect to Petitioner's proposed base rate level of \$5.98 million, this is
12 significantly lower than Petitioner's current base rate level of \$10.5 million for
13 wholesale power margins. However, the proposed 50/50 sharing of wholesale
14 power margins above and below this base rate level is the same treatment
15 currently utilized by Petitioner.

16 **Q: Do you agree with Petitioner's proposed treatment of WPM?**

17 A: No. Petitioner's proposed base rate level of \$5.98 million for wholesale power
18 margins is not an appropriate or accurate amount. I also oppose Petitioner's
19 proposal to continue 50/50 sharing of margins *below* an established base rate
20 amount.

21 Petitioner's proposed pro forma base rate amount of \$5.98 million is
22 significantly lower than its annual WPM in previous years and was calculated
23 utilizing an economically depressed 2009 calendar year projection of \$9.2 million
24 that was further reduced by projections that WPM results will incrementally

1 decline by another approximate \$3 million in 2010. The recent poor economic
2 conditions provide for the lower demand and lower LMP, which in turn results in
3 lower wholesale power margins. However, as indicated by Mr. Jochum, should
4 the economy rebound and demand rise, LMP will likely return closer to historic
5 levels.⁷ Furthermore, Vectren South Witness Carl Chapman, indicated in
6 testimony that the recession has dropped LMP in MISO to unprecedented low
7 levels. Mr. Chapman further indicated that, to the extent conditions improve and
8 LMP becomes more “normal,” customers will share in the upside revenue
9 opportunity through Vectren South’s WPM mechanism.⁸ Mr. Chapman discloses
10 that LMP levels are not at a “normal” level. Once the economy improves, and
11 LMP returns to historic levels, then a \$5.98 million base rate amount for WPM
12 will not be a representative base rate amount.

13 **Q: Do you have an alternative proposal for treating WPM, should the**
14 **Commission deny the OUCC’s proposal regarding an Efficiency Incentive**
15 **Mechanism, as described in the testimony of OUCC Witness Dr. David E.**
16 **Dismukes?**

17 **A:** Yes. Consistent with Dr. Dismukes’ proposal, I recommend that \$10 million be
18 included in Petitioner’s base rates for WPM. Additionally, a \$10 million WPM
19 base rate amount is comparable to Petitioner’s current base rate amount of \$10.5
20 million, as well as the smallest WPM amount achieved by Petitioner over the past
21 five years in which actual WPM amounts were provided. Furthermore, in
22 comparison to Petitioner’s WPM test year amount of \$16 million and five-year
23 historical average of actual WPM, based on the amounts Petitioner provided for

⁷ See Vectren South Witness Ronald G. Jochum’s Testimony, Page 10, Lines 1-4.

⁸ See Vectren South Witness Carl L. Chapman’s Revised Testimony, Page 18, Lines 18-23.

1 the years 2004-2008, of \$17.1 million, \$10 million proves to be an achievable
2 base level.

3 Regarding sharing of WPM, I agree with Petitioner to continue sharing
4 50/50 WPM "above" the OUCC's recommended base rate amount of \$10 million,
5 but recommend Petitioner bear 100 percent of the costs "below" the OUCC's
6 recommended base rate amount. Additionally, the 50/50 split above the base rate
7 amount (with Vectren South bearing all costs below the base rate amount)
8 continues to provide an incentive for Petitioner to operate its power plants
9 efficiently and maximize investments, yet does not provide an unfair sharing
10 arrangement for the ratepayers that are assuming operation and maintenance
11 expenses and supporting the rate base through retail rates.

12 **Q: Should Petitioner's WPM sharing mechanism be continued?**

13 A: Yes. There will always be some amount of volatility for wholesale sales, since
14 wholesale results are based on often unpredictable or possibly inconsistent
15 factors, such as the availability of units, demand levels and the Midwest ISO's
16 LMPs. Current market price swings are further accentuated due to the economic
17 downturn, in which demand and LMP levels have dropped quite low, yet demand
18 and LMP levels could increase rapidly once the economy recovers and market
19 conditions improve. Therefore, based on the current economic circumstances, in
20 which there is an increased possibility of large market price swings, it seems
21 reasonable to continue the WPM sharing mechanism for purposes of this
22 proceeding.

23

V. Recommendations/Conclusion

Q: What do you recommend with regards to variable production costs and wholesale power margins within the RCRA?

A: I recommend the Commission:

(1) Deny Petitioner's request for tracking of variable production costs within the RCRA;

(2) Continue to permit WPM sharing within the RCRA; and

(3) Accept the recommendation to include \$10 million in base rates for wholesale power margins, as well as allow Petitioner and ratepayers to share wholesale power margins above this base rate amount on a 50/50 basis, but require Petitioner to bear 100 percent of costs below the base rate level, should the OUCC's initial proposal regarding treatment of WPM be denied.⁹

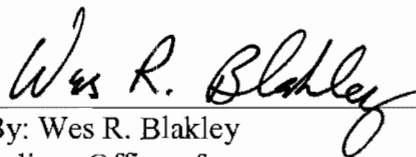
Q: Does this conclude your testimony?

A: Yes, it does.

⁹ See OUCC Witness David E. Dismukes' Testimony.

AFFIRMATION

I affirm, under the penalties for perjury, that the foregoing representations are true.

A handwritten signature in cursive script, reading "Wes R. Blakley", is written over a horizontal line.

By: Wes R. Blakley
Indiana Office of
Utility Consumer Counselor

June 25, 2010

Date

Cause No. 43839